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SUPREME COURT, U. S.
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In the

Supreme Court of the United States

October Term, 1970

No. 1157

Joseph B. Kauffman, on Behalf of Himself and All Other Shareholders of Defendant Externally Managed Mutual Funds and All Other Externally Managed Mutual Funds Affiliated Therewith or Related Thereto and, Derivatively, on Behalf of Defendant Externally Managed Mutual Funds and All Other Externally Managed Mutual Funds Affiliated Therewith or Related Thereto,

Petitioner,

—v.—

The Dreyfus Fund, Inc., *et al.*,

Respondents.

RESPONDENTS' JOINT BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Joseph B. Kauffman, on Behalf of Himself and All Other Shareholders of Defendant Externally Managed Mutual Funds and All Other Externally Managed Mutual Funds Affiliated Therewith or Related Thereto and, Derivatively, on Behalf of Defendant Externally Managed Mutual Funds and All Other Externally Managed Mutual Funds Affiliated Therewith or Related Thereto,

Petitioner,

—v.—

The Dreyfus Fund, Inc., *et al.*,

Respondents.

RESPONDENTS' JOINT BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

This Joint Brief in Opposition to Petition for Writ of Certiorari is submitted on behalf of those defendants in the District Court who participated as appellants in the interlocutory appeal to the United States Court of Appeals for the Third Circuit.

Opinions Below

The opinion of the District Court for the District of New Jersey is reported at 51 F.R.D. 18. The opinion of the United States Court of Appeals for the Third Circuit is reported at 434 F.2d 727.

Statutes and Rules Involved

The petition involves Section 4 of the Clayton Act, 15 U.S.C. § 15, and Rules 23 and 23.1 of the Federal Rules of Civil Procedure. Each of these provisions is set forth in Respondents' Appendix 1a-5a (hereinafter referred to as "Resp. App.").

Questions Presented

Despite the intricate array of multi-part questions presented by petitioner, the issues presented, which were decided in favor of respondents by the Court of Appeals, are as follows:

1. Does a shareholder of a mutual fund have a personal (in addition to a derivative) right of action to recover for his own account damages allegedly sustained by his corporation by reason of violations of the antitrust laws?

2. Does a shareholder of a mutual fund who sues derivatively on behalf of that fund have standing to bring a "class derivative" action on behalf of other mutual funds in which he does not own shares?

Statement of the Case

As previously noted, petitioner seeks a writ of certiorari addressed basically to the two questions stated above. Upon an interlocutory appeal pursuant to 28 U.S.C. § 1292(b), the Court of Appeals for the Third Circuit answered both of these questions in the negative.

In his complaint (Resp. App. 6a-43a), petitioner alleges that he is a shareholder of Manhattan Fund, Inc., Fi-

delity Trend Fund, Inc., The Putnam Growth Fund and The Dreyfus Fund, Inc. He seeks to utilize these shareholdings in such manner as to give him standing to mount, under both the antitrust and securities laws and on behalf of an indeterminate number of funds and their millions of shareholders, what the District Court described as "an attack nationwide upon the entire mutual fund industry." Petitioner's Appendix A8 (hereinafter referred to as "Pet. App.").

There are 141 defendants named in the complaint. Four are the mutual funds in which petitioner owns shares; four are the investment advisers of those funds; and four are individuals, each of whom is or was an affiliated director, within the meaning of the Investment Company Act of 1940, 15 U.S.C. § 80a-2(a)(3), of one of those four funds and its investment adviser.

The remaining 129 named defendants* have no relationship to petitioner or to his four funds. They consist of 61 mutual funds in which petitioner owns no shares; 34 investment advisers which serve one or more of those 61 funds; 33 individuals, each of whom serves as a director of one or more of the funds in which petitioner owns no shares; and the Investment Company Institute. However, the precise number and identity of defendants is unknown, since petitioner purports to sue each named defendant other than the Investment Company Institute as a representative of a class of other funds, advisers or directors

* The defendants were apparently selected without regard to their supposed "culpability", since plaintiff chose to name only funds with assets in excess of $100,000,000 and advisers and directors of such funds. Moody's, Bank & Finance Manual a53 (1968) and Wiesenberger, Investment Companies, Mutual Funds and Other Types 104-109 (1968 Ed.).

who are said to be "affiliated therewith or related thereto". See, *e.g.*, Compl. ¶ 5(a); Resp. App. 10a.

The complaint purports to set forth claims under three counts. Count I alleges that defendants, in violation of the antitrust laws, conspired to stabilize the management fees paid by the mutual funds to their investment advisers, to limit competition in the business of providing investment advisory services and to refrain from providing for internal investment management. Count II alleges that defendants, in violation of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.*, followed brokerage practices which permitted the advisers to utilize improperly for their own benefit portions of brokerage commissions paid by the mutual funds in connection with fund portfolio securities transactions. Count III alleges that defendants violated the disclosure provisions of various federal securities laws* by failing to disclose the unlawful conduct charged in the first two counts.

Under each of these counts, petitioner purports to assert:

(i) claims in his own primary right as a shareholder of the four mutual funds in which he owns shares;

(ii) by virtue of the purported individual claims:

(a) representative claims on behalf of the other shareholders of the four mutual funds in which he owns shares;

(b) representative claims on behalf of the shareholders of the 61 mutual funds in which he does not own shares; and

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* The Investment Advisers Act of 1940, 15 U.S.C. § 80b-6; the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.*; and the Securities Exchange Act of 1934, 15 U.S.C. § 78n.

(c) derivative claims of the shareholders of the 61 mutual funds in which he owns no shares;

(iii) derivative claims on behalf of the four funds in which he owns shares; and

(iv) by virtue of the derivative claims described in (iii), "class derivative" claims on behalf of the 61 funds in which he owns no shares.

Respondents moved in the District Court for orders (Resp. App. 44a-45a):

(1) Pursuant to Rules 23 and 23.1 of the Federal Rules of Civil Procedure, dismissing the action on the grounds that, on the face of the Complaint, plaintiff does not fairly and adequately represent the interests of the funds or their shareholders;

(2) Pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, dismissing all claims asserted individually, or representatively on behalf of individual shareholders, on the ground that all of the claims asserted are necessarily derivative in nature;

(3) Pursuant to Rules 12(b)(6), 23 and 23.1 of the Federal Rules of Civil Procedure, dismissing each of Counts I, II and III to the extent they seek relief (a) on behalf of funds of which plaintiff is not a shareholder, and (b) on behalf of shareholders of funds of which plaintiff is not a shareholder, on the ground that a party may not maintain an action on behalf of a corporation, or shareholders of a corporation, unless he himself is a shareholder of that corporation; and

(4) Pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, dismissing Counts II and III for failure to state a claim upon which relief can be granted on the ground the conspiracy alleged therein does not

constitute a violation of the statutes under which relief is sought.*

The District Court denied these preliminary motions and, pursuant to 28 U.S.C. § 1292(b), certified the issues raised. Pet. App. A1-A9.

The Court of Appeals reversed the judgment of the District Court and, in its opinion, held that the complaint should be dismissed "except to the extent it permits appellee to maintain secondary or derivative actions in behalf of the four mutual funds in which he owns shares, *i.e.*, The Dreyfus Fund Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., and The Putnam Growth Fund". Pet. App. A25-A26.

In reaching its conclusion, the Court of Appeals, following "the fundamental tenet of corporation law which treats the corporate body as an entity—indeed, as a person—separate and distinct from those who own shares of its stock" (Pet. App. A16), held that the complaint did not state a primary or personal cause of action to recover damages on behalf of individual shareholders. Pet. App. A14-A18. While permitting the action to continue as a derivative action on behalf of the four funds of which petitioner is a shareholder (Pet. App. A19, A25-A26), the Court of Appeals rejected petitioner's attempt to pyramid

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* In addition to the above motions directed to the standing and capacity of petitioner, respondents filed a number of additional motions in the District Court, including motions challenging jurisdiction, venue and process as well as the legal sufficiency of the complaint. Resp. App. 44a-46a. The District Court directed that the standing and capacity motions be briefed, argued and decided, and that the remainder be held in abeyance for later resolution. Substantial threshold questions thus remain for decision by the District Court, whatever action may be taken by this Court with respect to the Petition.

his holdings in these four funds into standing to sue on behalf of an indeterminate number of funds of which he is not a shareholder (Pet. App. A18-A24), pointing out that "ownership in a corporation [is] . . . the prerequisite for bringing a derivative action in its behalf". Pet. App. A21.

The Court of Appeals also considered respondents' motion to dismiss the action in its entirety because of petitioner's conflicts of interest in seeking an adjudication of liability against the same mutual funds he purported to represent. In view of its holding that petitioner could not maintain a primary right of action against the defendant investment companies, the Court stated that it was not convinced that the case, as limited by its decision, would present any disabling conflicts of interest or disabling antagonisms and left it to the District Court to guard against them.

Reasons for Denying the Petition

The decision below permits petitioner to proceed in a derivative capacity in respect of his claims on behalf of each of the four funds of which he is a shareholder; it does not limit his right to seek relief on behalf of those funds. However, it does deny him the additional right to pursue those same claims in his individual capacity. It further denies him standing to sue on behalf of corporations of which he is not a shareholder.

These rulings do not present any issue worthy of review by this Court. The Court of Appeals followed (1) an unbroken line of decisions holding that corporate shareholders do not have personal or primary causes of action—

in addition to derivative or secondary rights—to recover for damages allegedly inflicted upon their corporations in violation of the antitrust laws, and (2) the clear requirements of Rule 23.1—"amounting to a legal principle" (Pet. App. A21)—that one who does not own shares in a corporation is not qualified to bring a derivative action on its behalf.

Petitioner's contentions that the decision below is in conflict with the decisions of other Circuits and even of this Court, and that it presents important questions regarding the enforcement of antitrust policy, are demonstrably without merit.

A. The Court of Appeals' Holding That Only Derivative Claims Can Be Maintained Does Not Conflict With Any Decisions of This Court or of Any Circuit and Presents No Important Question Regarding Private Enforcement of the Antitrust Laws.

The complaint is based on alleged injuries to the defendant mutual funds themselves, *i.e.*, corporate harm resulting from payment by the funds of allegedly excessive management fees and brokerage commissions. Consequently, the Court below held that the allegations gave rise only to claims which may be asserted by those funds directly or derivatively by their shareholders acting on their behalf.

Petitioner, however, contends that the Court of Appeals erred in ruling that Count I (the antitrust claim) did not also state *personal* causes of action because of the allegedly unique structure of mutual funds and the public policy of the antitrust laws.

Petitioner made these same contentions before the Court below. Nonetheless, the Court of Appeals ruled in accord-

ance with settled principles of corporate and antitrust law that to permit a shareholder to recover "indirect" personal damages in his own right where "direct" and primary harm, in violation of the antitrust laws, has been done to the corporate enterprise, would be to abolish the distinction between a shareholder's derivative right and a claim asserted in the shareholder's own primary right. In so ruling, the Court of Appeals reaffirmed its holding in the leading case of *Ash* v. *International Business Machines, Inc.*, 353 F.2d 491, 494 (3d Cir. 1965) (Hastie, J.), *cert. denied*, 384 U.S. 927, that:

> "... [W]ere the rule otherwise, the distinction between a stockholder's derivative claim and a claim exercised in his primary right would disappear, and the public policy based strictures on derivative suits could be avoided merely by asserting that economic harm to a corporation in itself constituted justiciable personal injury to each owner of stock in the corporation."

As in *Ash* and its predecessor *Loeb* v. *Eastman Kodak Co.*, 183 F. 704 (3d Cir. 1910), whenever the question has been considered, it has been recognized that a stockholder has no cause of action in his own right for an antitrust injury inflicted upon his corporation.* The cited deci-

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* See, *e.g.*, *Bookout* v. *Rehine Chain Theaters, Inc.*, 253 F.2d 292, 294 (2d Cir. 1958) ("[I]t is well established that ... [a stockholder] has no separate claim under the Anti-Trust Acts. ...") ; *Productive Inventions, Inc.* v. *Trico Products Corp.*, 224 F.2d 678, 679 (2d Cir. 1955) ("Shareholders ... of corporations ... have been held not to have standing to sue for treble damages.") ; *Peter* v. *Western Newspaper Union*, 200 F.2d 867, 872 (5th Cir. 1953) ("[I]t is well settled that a stockholder in a corporation as such is not injured in his business or property within the meaning of ... [Section 4 of the Clayton Act] merely because the unlawful combination or conspiracy has caused injury to the

sions under Section 4 of the Clayton Act are in accord with the general principles set forth by this Court in *Pittsburgh & W. Va. Ry.* v. *United States*, 281 U.S. 479, 487-88:

> "The injury feared is the indirect harm which may result to every stockholder from harm to the corporation. Such stockholder's interest is clearly insufficient to give the Pittsburgh a standing independently to institute suit to annul this order."

Petitioner's effort to create the appearance of a conflict between the Second and Third Circuits, on the one hand, and the Fourth, Eighth and Ninth Circuits, on the other, relating to the proper standard to be applied in determining standing under Section 4 of the Clayton Act—that is, whether the proper test is the directness or indirectness of the alleged injury or whether the injured party is within the so-called "target area"—is unavailing in the light of these decisions.

In support of his contention, petitioner places heavy reliance on the decision of the Ninth Circuit in *Mulvey* v. *Samuel Goldwyn Productions*, 433 F.2d 1073 (9th Cir. 1970). See Petition pp. 8-9, 11. This reliance is misplaced,

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business or property of the corporation as a result of which the value of its stock has been reduced."); *Congress Building Corp.* v. *Loew's, Inc.*, 246 F.2d 587, 591 (7th Cir. 1957) ("To permit individual stockholder recovery would run counter to the traditional treatment of corporate injury that the corporation is the proper party to redress corporate wrongs."); *Walker Distributing Co.* v. *Lucky Lager Brewing Co.*, 323 F.2d 1, 10 (9th Cir. 1963), *cert. denied*, 385 U.S. 976 ("Walker Distributing Company, Inc. was the distributor, and there are no allegations showing that the appealing individuals were in any way affected by Lucky's conduct save in their capacity as Walker Distributing's stockholders. This is not enough.").

since *Mulvey* did not purport to reverse the Ninth Circuit's earlier express holding in *Walker Distributing Co.* v. *Lucky Lager Brewing Co.*, 323 F.2d 1, 10 (9th Cir. 1963), *cert. denied*, 385 U.S. 976, that a shareholder does not have a personal right of action under the antitrust laws. In *Mulvey*, the relationship between corporation and shareholder was not even involved and, as recently as 1969, the Ninth Circuit reaffirmed the general principle that individual shareholders do not have primary causes of action for damages inflicted upon their corporations. *Erlich* v. *Glasner*, 418 F.2d 226, 228 (9th Cir. 1969).

The Fourth Circuit is in accord. That Circuit, in *South Carolina Council of Milk Producers, Inc.* v. *Newton*, 360 F.2d 414 (4th Cir. 1966), *cert. denied*, 385 U.S. 934, a decision relied upon by petitioner as establishing the purported conflict (Petition pp. 10-11), specifically reaffirmed the continued vitality of the rule that a corporate shareholder may not sue individually to recover for antitrust injuries inflicted upon his corporation, pointing out that in such cases "the injury to the plaintiff [is] derivative and the corporate entity intervene[s] to suffer the damage immediately and entirely". 360 F.2d at 417. Similarly, the Eighth Circuit has also followed the general principle that individual shareholders do not have primary causes of action for damages inflicted upon a corporation. *Brictson* v. *Woodrough*, 164 F.2d 107, 109 (8th Cir. 1947), *cert. denied*, 334 U.S. 849.

Likewise without substance is petitioner's contention that the Petition raises an important issue regarding the private enforcement of antitrust policy. Petition p. 8. The premise of this argument appears to be that, unless petitioner is held to have such a personal or primary right,

wrongs indirectly sustained by him and other shareholders would go unremedied and the effectiveness of the private action as a means of enforcing the antitrust policy of the United States would be diluted, if not destroyed. Petition p. 12. Nowhere, however, has petitioner suggested any reason why a corporate recovery would not provide complete relief from the wrongs of which he complains.

Indeed, the Court below was careful to point out that its result *would not* leave petitioner without remedy:

> "[W]e recognize that a shareholder of a corporation has standing to maintain a derivative action to enforce rights in that corporation. Rule 23.1. . . . Accordingly, putting aside the question of a possible conflict of interest, there is no doubt that appellee may litigate derivative actions in behalf of the four funds in which he holds shares." Pet. App. A19.

Thus, cases such as *Arnold Tours, Inc.* v. *Camp*, 397 U.S. 315; *Association of Data Processing Service Organizations, Inc.* v. *Camp*, 397 U.S. 150; *Barlow* v. *Collins*, 397 U.S. 159; *Perkins* v. *Standard Oil Co.*, 395 U.S. 642; and *Billy Baxter, Inc.* v. *Coca-Cola Co.*, 431 F.2d 183 (2d Cir. 1970), *petition for cert. filed*, 39 U.S.L.W. 3239 (U.S. Nov. 20, 1970) No. 969, are inapposite because they involved plaintiffs who would have been without a remedy of any kind unless they were accorded standing to sue. Here, the only question is whether, on the one hand, the proper party-plaintiff is the corporation (or one suing derivatively on its behalf), or, on the other hand, its shareholders suing in their primary right on their own behalf. This question has uniformly been answered by holding that it is the corporation (or a shareholder suing derivatively on its behalf) which is the proper party-plaintiff and that it is the corporation which

properly would be the recipient of any recovery. The instant case is not an appropriate vehicle for passing on the question of standing under the Clayton Act because petitioner, unlike other plaintiffs asserting "indirect injury", is protected by the corporation's recovery in the derivative action.

The cases cited by petitioner simply do not support his claim that a mutual fund shareholder "has standing to sue *in his own right* as well as derivatively for *any* violations of law involving mutual funds" and that the same policy should apply under the antitrust laws. Petition pp. 1-2. Moreover, petitioner's assertion that he has standing under the Investment Company Act is directly contrary to the Court of Appeals' holding that the complaint does not state individual claims under the federal securities laws. Pet. App. A14, A18, A24, A26. Since petitioner has not sought this Court's review of that determination, the Court of Appeals' decision is final and binding.

There is, moreover, no reason of policy why mutual fund shareholders—as opposed to corporate shareholders generally—should be singled out for preferential treatment under the antitrust laws. If shareholders are allowed to recover corporate damages for their own account, the antitrust injury to the enterprise as a whole will go unremedied, for, by definition, permitting the shareholders a recovery in their own right will mean that the corporate treasury will never receive compensation.

Petitioner cannot rely on the redemption feature of mutual fund shares to avoid the "fundamental tenet of corporation law which treats the corporate body as an entity —indeed, as a person,—separate and distinct from those

who own shares of its stock". Pet. App. A16. As the Court of Appeals said:

> "That the worth of a share of appellee's stock is directly proportionate to the value of a mutual fund's net assets is insufficient to destroy these separate identities, to alter the basic shareholder-corporation relationship, and to thereby confer upon appellee legal rights peculiar to the corporation. Nowhere in the cases do we find authority for the proposition that the ease and capacity of evaluating a shareholder's redemptive value of mutual fund shares can vest in him a pro-rata share of the corporation's primary right to sue. To accept this would be to convert an orthodox corporate structure to a general partnership or joint venture with each participant a principal and agent for the others." Pet. App. A16.

See also *Herman* v. *Steadman*, 50 F.R.D. 488 (S.D.N.Y. 1970); *Weiner* v. *Winters*, 50 F.R.D. 306 (S.D.N.Y. 1970).

Thus, petitioner's bootstrap denomination of the shareholders of a mutual fund as "customer-shareholders" proves nothing. It does not change their legal status as shareholders. Even sole shareholders have only derivative claims for wrongs to their wholly-owned corporations. *Mullins* v. *First Nat'l Exchange Bank*, 275 F. Supp. 712, 721 (W.D. Va. 1967); *Liken* v. *Shaffer*, 64 F. Supp. 432, 438-439 (N.D. Iowa 1946).

The typical mutual fund is a corporation organized and existing under state law. It has a board of directors elected by thousands of public shareholders. It owns its own assets, purchases and sells securities as a corporation, enters into contracts as a corporation, holds itself out to the public as a corporation, and in all ways conducts its business as a corporation. Its stockholders are insulated from per-

sonal liability for acts or debts of the corporation; they cannot personally sue to enforce corporate debts or to recover on corporate causes of action.

The shareholder of a mutual fund, like the shareholder of any other corporation, has an undivided interest in the assets of his corporation and no personal rights in particular corporate assets. Accordingly, if there is any recovery in this case, it must go to the funds and not to individual shareholders.*

B. The Court of Appeals' Holding That a Plaintiff Cannot Sue Derivatively on Behalf of Corporations in Which He Does Not Own Stock Presents No Issue Worthy of Review by This Court.

Rule 23.1 of the Federal Rules of Civil Procedure lays down the rule that a derivative suit can be maintained only by a shareholder:

> "In a derivative action brought by one or more *shareholders* or *members* to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a *shareholder* or *member* at the time of the transaction of

* The proposition that petitioner is, in effect, asking this Court to accept was flatly rejected by the SEC after an exhaustive and painstaking study. The SEC stated:

> "The Commission believes that it would be most unwise to accept the foregoing analysis for regulatory purposes. It is clearly rejected in the Act. The courts also have held that mutual fund shareholders are not merely individual advisory clients, and that the funds have rights that can be enforced by their shareholders just as other types of corporations have rights that can be enforced by their shareholders (citing cases)." SEC, Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 76 (1966).

> which he complains or that his share or membership thereafter devolved on him by operation of law. . . ." (Emphasis added.)

The "shareholder" limitation in derivative actions has been a fixed and important principle of federal practice since *Hawes* v. *Oakland*, 104 U.S. 450;* and no exception is recognized.

In the Courts below petitioner sought to nullify the clear language of Rule 23.1 through the creation of a "class derivative" form of action, which, he contended, clothes a non-shareholder with standing to assert derivative claims on behalf of corporations in which he has no interest and in which he owns no shares. He advanced two theories to support his contention. On the one hand, petitioner argued that since "his" funds could allegedly bring a class action on behalf of all mutual funds pursuant to Rule 23, he, as a shareholder suing on their behalf, can bring a class action on behalf of all such mutual funds. Alternatively, he argued that as the self-declared representative of the shareholders of all 65 funds, he is entitled to assert the derivative rights of all shareholders on behalf of all 65 funds. Petitioner has abandoned the latter claim which, along with the former claim, was rejected in the Court below. Pet. App. A18.

In following the express requirement of Rule 23.1 that only a shareholder of a corporation may bring a derivative action on its behalf, and in rejecting petitioner's attempt to sue derivatively on behalf of corporations of which he

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* The principle of *Hawes* v. *Oakland* was promptly adopted as Equity Rule 94, 104 U.S. ix, and has been continued in effect ever since, with only minor revisions, as Equity Rule 27 in 1913, 226 U.S. 629, 656, the original Rule 23(b), Fed. R. Civ. P., and now as Rule 23.1, Fed. R. Civ. P.

is not a shareholder, the Court of Appeals was clearly correct. As the Court pointed out in its well-reasoned decision:

> "The timber of sound reason forms the conceptual underpinning of the rule requiring stock ownership in a corporation as the prerequisite for bringing a derivative action in its behalf. Only by virtue of the shareholder's interest, which has been described as 'a proprietary interest in the corporate enterprise which is subject to injury through breaches of trust or duty on the part of the directors,' *Ashwander* v. *Tennessee Valley Authority*, 297 U.S. 288, 321 (1936), does equity permit him 'to step into the corporation shoes and seek in its right the restitution he could not demand in his own.' Standing is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal plaintiff may acquire *qua* stockholder of the corporation which is the real party in interest. Without this relationship, there can be no standing, 'no right in himself to prosecute this suit,' *Hawes* v. *Oakland* (Hawes v. Contra Costa Water Co.), 104 U.S. 450, 462; *Venner* v. *Great Northern Railway*, 209 U.S. 24, 34 (1908)." Pet. App. A21.

The Court of Appeals also concluded:

> "[T]he fund is not the plaintiff in the case at bar, and the only right the individual derivative plaintiff possesses is a secondary one—a right which not only defines his standing to sue but also limits the extent of the possible recovery, *i.e.*, the damage sustained by the corporation in which he is a shareholder." * Pet. App. A24.

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* The clear implication of this conclusion is that petitioner cannot be deemed to be a member of the class of the 65 mutual funds as required by Rule 23(a):

> "One or more *members* of a class may sue or be sued as representative parties on behalf of all . . . ." (Emphasis added.) See also, *Hansberry* v. *Lee*, 311 U.S. 32.

No authority has been found to support the claim that a shareholder-plaintiff may use Rule 23 as a device to give him standing to bring suit on behalf of corporations in which he does not own shares and thereby override the carefully drawn provisions of Rule 23.1. Indeed, every such effort to circumvent Rule 23.1 in this manner has been flatly rejected. *Herman* v. *Steadman*, 50 F.R.D. 488 (S.D. N.Y. 1970); *Weiner* v. *Winters*, 50 F.R.D. 306 (S.D.N.Y. 1970); *Verrey* v. *Ellsworth*, 303 F. Supp. 497, 499-501 (S.D.N.Y. 1969). The courts have uniformly held that only a shareholder of a particular investment company has standing to sue on its behalf. See *SEC* v. *General Time Corp.*, 407 F.2d 65, 71 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026; *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783, 792-94 (8th Cir. 1967).*

The requirements for maintaining a derivative action** were split off from the old class action rule and separately stated for the precise purpose of emphasizing the distinctive nature of the derivative suit and the limitation on the class of persons entitled to maintain it.

> "A derivative action by a shareholder of a corporation or by a member of an unincorporated association has distinctive aspects which require the special provisions set forth in the new rule." Notes of Advisory Commit-

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* The recent amendments to Section 36 of the Investment Company Act of 1940 reflect the Congressional intention that only shareholders of a fund may bring an action on behalf of that fund. See Investment Company Amendments Act of 1970, §20, 84 Stat. 1413, 1428-30 (1970).

** Prior demand by the shareholder upon directors or shareholders and verification of the complaint are both important requirements of the Rule. Neither requirement can be met by petitioner who purports to sue on behalf of 61 arbitrarily selected mutual funds in which he owns no shares.

tee on Rules, Fed. R. Civ. P. 23.1, 28 U.S.C.A. at p. 136 (Supp. 1970).

See also 3B Moore, Federal Practice ¶ 23.1.16 (2d ed. 1969); Kaplan, "Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)," 81 Harv. L. Rev. 356, 387 n. 118 (1967).

In this context, the Court below, quoting Professor Wright, pointed out:

> *"In the 1966 revision it was decided to deal independently with derivative actions by stockholders in a separate Rule 23.1. Thus the general class action rule, Rule 23, no longer applies to stockholders' derivative suits."* Pet. App. A22 quoting Wright, Law of Federal Courts 318-319. (Emphasis in Court of Appeals' opinion.)

None of the cases cited by petitioner at pages 19 and 20 of his Petition (*Kahan* v. *Rosenstiel*, 424 F.2d 161 (3d Cir. 1970), *cert. denied*, 398 U.S. 950; *Green* v. *Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977; *Eisen* v. *Carlisle & Jacquelin*, 391 F.2d 555 (2d Cir. 1968); *Illinois* v. *Harper & Row Publishers, Inc.*, 301 F. Supp. 484 (N.D. Ill. 1969)) was a derivative suit, and Rule 23.1 was in no way involved.

Petitioner's reliance on this Court's decision in *Ross* v. *Bernhard*, 396 U.S. 531, is likewise misplaced. That case stands only for the proposition that the Seventh Amendment "right to jury trial attaches to those issues in derivative actions as to which the corporation, if it had been suing in its own right, would have been entitled to a jury." 396 U.S. at 532-33. Nowhere was it suggested that the limited right conferred on a shareholder by Rule 23.1 to bring a

derivative suit on behalf of his corporation stripped other corporations of the protective provisions embodied in Rule 23.1.

The provisions of Rule 23.1 were not intended to be circumvented, as petitioner attempts here, by those who would bring an action

> "not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or in its stockholders." *Beneficial Industrial Loan Corp.* v. *Smith*, 170 F.2d 44, 51 (3d Cir. 1948), *aff'd sub nom. Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541.

Finally, respondents invite this Court's attention to one additional consideration. Were petitioner allowed to sue on behalf of corporations of which he is not a shareholder, he would re-establish himself in the position of mutually irreconcilable and antagonistic loyalties established by the complaint as drawn.

In the Courts below, respondents urged that petitioner's complaint presented a host of disabling conflicts of interest by reason of petitioner's suit on behalf of the same mutual funds against which he was simultaneously seeking an adjudication of liability. The Court of Appeals concluded that, in view of its holding that petitioner may not maintain a primary right of action against any of defendant mutual funds, "we are not convinced that a conflict of interest will be presented when we remand this case to the district court for further proceedings on the derivative claims brought on behalf of the four funds in which appellee holds shares". Pet. App. A24-A25.

Rules 23 and 23.1 of the Federal Rules of Civil Procedure expressly provide, in a prohibitive and cautionary manner,

that an action in which a plaintiff seeks to represent other parties may not be maintained unless the party seeking to enforce the rights of the class or of the corporation will "fairly and adequately" protect the interests of the class (Rule 23(a)(4)) or will "fairly and adequately" represent the interests of the shareholders or members of the corporation or association (Rule 23.1). This Court has long recognized that in order for a party fairly and adequately to represent a class, his interests must be wholly compatible with and not antagonistic to those whom he would represent. *Hansberry* v. *Lee*, 311 U.S. 32.

The conflicts of interest apparent on the face of the complaint violate all of these principles. The complaint clearly exposes each fund to liability not only to its own shareholders, but also to each of the other funds and to the shareholders therein. By casting himself as the representative of these same funds, petitioner has arrayed them in a complex of simultaneously offensive and defensive postures in complete disregard of the basic duty of loyalty which he owes to each.

It is petitioner himself who has created these irreconcilable conflicts through a perversion of Rules 23 and 23.1 in order to maximize the number of parties involved in this action. A derivative as well as a class action requires a representative party who is free of conflict of interest, and the expediency of a derivative or of a class action cannot be used as an excuse to compromise the very principle of undivided loyalty upon which these actions depend. *Guttman* v. *Braemer*, CCH Fed. Sec. L. Rep. ¶ 92,889, at 90,315-16 (S.D.N.Y. December 15, 1970). It is this untenable position that petitioner is seeking to re-establish through his Petition.

CONCLUSION

For the foregoing reasons, respondents respectfully submit that the Petition should be denied.

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Certificate of Service

I, JAMES C. PITNEY, a member of the Bar of the Supreme Court of the United States, hereby certify that on this 19th day of February, 1971, three copies of Respondents' Joint Brief in Opposition to Petition for Writ of Certiorari were served on behalf of all Respondents in this proceeding, by first class mail, postage prepaid, on each of the following attorneys:

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I further certify that all parties required to be served have been served.

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